COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

BAY STATE GAS COMPANY	)	D.T.E. 02-73

INITIAL BRIEF OF
BAY STATE GAS COMPANY

I. INTRODUCTION

On November 8, 2002, pursuant to G.L. c. 164, §§ 14, 15 and 16 Bay State Gas Company ("Bay State" or the "Company") filed a request for authorization to issue and sell long term debt in an aggregate amount not to exceed $50,000,000, at face value, to its affiliate, NiSource Finance Corp. Pursuant to notice duly issued, the Attorney General filed a notice of intervention. In addition, Local 273, Utility Workers Union of America, AFL-CIO ("Local 273") and Southern Union Gas Company were granted limited participant status. The Department conducted public and evidentiary hearings at its offices on December 12, 2002, at which the Company sponsored the testimony of Vincent Rea. The evidentiary record consists of Bay State's initial filing, responses to information requests and record requests. In accordance with the established procedural schedule, Bay State hereby submits its Initial Brief.

II. DESCRIPTION OF THE PROPOSED FINANCING

A. <u>$50,000,000 Long-Term Debt Issuance</u>

Bay State proposes to issue and sell at face value to its affiliate NiSource Finance Corp. an unsecured note(s) in an amount not to exceed fifty million dollars ($50,000,000) with an interest rate not to exceed seven and three quarters percent (7.75%) and having a term not to exceed 20 years (the "Note"). Exhs. BSG-1; BSG-2, Tr. at 15. The precise interest rate for the note will be fixed at the time it is issued, but based on current market conditions, Bay State requests that the financing be approved at a rate not to exceed 7.75% for a term of up to twenty years. Exh. BSG-1; Tr. at 15. The proposed interest rate corresponds to current pricing being offered companies with financial profiles similar to Bay State. Exh. BSG-2, at 4. Further, consistent with rules promulgated pursuant to The Public Utility Holding Company Act of 1935, the interest rate reflects no mark-up by the lender, NiSource Finance Corp. Exh. BSG-2, at 4. Bay State also requests that it retain the flexibility to issue the Note for a ten-year term if such term continues to present a more attractive rate, so that the Company may ensure that it receives the most advantageous rate of financing. Tr. at 15. The Company's most recent information is that, as of December 13, 2002, a ten-year note could be offered at 6.75%, and possibly less. Tr. at 15; RR-AG-2. Should rates remain at this level, the Company's preference would be to issue a 10-year note(s). Tr. at 18.

B. Purpose of funds

Over the past four months, approximately $25 million of Bay State's long-term debt matured. Exh. BSG-2, at 2. The Company temporarily rolled over such maturities as short-term debt, to allow time to determine the best alternative for refinancing. Id. By the end of 2002, an additional $28 million of long-term debt will be maturing. Id. Bay State proposes to pay down short-term debt and refinance those previously matured or soon to mature long-term debt issuances that have been previously issued for ongoing utility purposes. Exh. BSG-3, at 3; Tr. at 129. The proposed issuance also will maintain the structure of financing that the Company has had in place historically. Tr. at 128-129.

C. Bay State's Capital Structure

On a pro forma basis, including issuance of the proposed note(s) and the refinancing of certain long-term debt, Bay State's capital structure would consist of 55.99% equity and 44.01% debt capital. Exh. BSG-9. As of September 30, 2002, Bay State's capitalizable utility plant in service was $708,069,613, with accumulated depreciation of $241,286,711, resulting in net capitalizable utility plant of $466,782,902.[1] Exh. BSG-8. As of September 30, 2002, the Company had issued and outstanding: (1) long-term debt amounting to $80,500,000; (2) 1,000 authorized shares of common stock, $1 par value, of which 100 shares are issued and outstanding; and (3) additional paid in capital exclusive of premiums of $145,596,870. Exhs. BSG-1, BSG-8. An additional $42,998,000 included in current short-term debt reflects long-term debt that has matured or will mature within the next twelve months. Exh. BSG-5; Tr. at 146. The Company's common equity balance as of September 30, 2002 was $166,021,666. Exh. BSG-9. Accordingly, Bay State has a sufficient balance of total capitalizable plant, less reserves for depreciation, against which the proposed $50,000,000 of debt securities may be authorized. Exhs. BSG-1, BSG-8.

III. STANDARD OF REVIEW

To approve a gas or electric company's proposed issuance of stocks, bonds, or other evidence of indebtedness for periods in excess of one-year, the Department will examine whether the proposed issuance meets two tests. First, the Department considers whether the issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14. <u>Fitchburg Gas & Electric Light Company v. Department of Public Utilities</u>, 395 Mass. 836, 842 (1985) ("<u>Fitchburg II</u>"), citing <u>Fitchburg Gas & Electric Light Company v. Department of Public Utilities</u>, 394 Mass. 671, 678 (1985)

[1] Bay State's net plant calculation does not include the Company's gas inventory balance as of September 30, 2002.

("Fitchburg I"). Second, the Department will consider whether the Company has met the net plant test. Colonial Gas Company, D.P.U. 84-96 (1984). Under the net plant test, which is derived from G.L. c. 164, § 16, the Department examines whether the fair structural value of the plant and of the land and the fair value of the gas inventories owned by such company exceeds the company's outstanding stock and debt. See, Commonwealth Electric Company d/b/a NSTAR Electric, D.T.E. 02-51, at 3 n.3 (2002).

For purposes of G.L. c. 164, § 14, the Supreme Judicial Court has found that "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II at 836, citing Lowell Gas Light Company v. Department of Public Utilities, 319 Mass. 46, 52 (1946). Where no issue exists as to the reasonableness of management decisions regarding the requested financing, the Department will limit its Section 14 review to the facial reasonableness of the purpose to which the proceeds of the proposed issuance will be put. Commonwealth Electric Company d/b/a NSTAR Electric, D.T.E. 02-51, at 4, citing Canal Electric Company, et al, D.P.U. 84-152, at 20 (1984); Colonial Gas Company, D.P.U. 90-50, at 6 (1990).

With respect to the net plant test, a company is required to present evidence that its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long-term debt and its preferred and common stock outstanding) and will continue to do so following the proposed issuance. Commonwealth Electric Company d/b/a NSTAR Electric, D.T.E. 02-51, at 4, citing Colonial Gas Company, D.P.U. 84-96, at 5 (1984).

G.L. c. 164, § 15 provides that a gas or electric company issuing long-term bonds or notes in excess of $1 million in face amount payable at periods of more than five years after the date thereof invite purchase proposals through newspaper advertisements. The Department may grant an exemption from this advertising requirement if it finds such exemption is in the public interest. G.L. c. 164, § 15. The Department has found it in the public interest to grant an exemption from the advertising requirement where there has been a measure of competition in private placement. See, e.g., Western Massachusetts Electric Company, D.P.U. 88-32, at 5 (1988); Eastern Edison Company, D.P.U. 88-127, at 11-12 (1988); Berkshire Gas Company, D.P.U. 89-12, at 11 (1989). The Department also has found that it is in the public interest to grant a company an exemption from the advertising requirement when a measure of flexibility is necessary in order for a company to enter the bond market in a timely manner. Western Massachusetts Electric Company, D.P.U. 88-32, at 5 (1988); Bay State Gas Company, D.P.U. 93-14 (1993).

The Department has also found that the "purpose behind G.L. c. 164, § 15 is to promote a competitive debt market, with the intent of creating lower debt costs for utilities and subsequent savings to ratepayers." MECo/EUA Merger, D.T.E. 99-47.

IV. BAY STATE'S PROPOSAL IS CONSISTENT WITH THE DEPARTMENT'S STANDARD OF REVIEW

A. Bay State's Proposed Issuance is Reasonably Necessary to Meet Bay State's Service Obligations

Bay State has demonstrated that the issuance of a $50,000,000 promissory note for a term not to exceed 20 years at a rate not to exceed 7.75% is reasonably necessary to accomplish some legitimate purpose in meeting the Company's service obligations pursuant to G.L. c. 164, § 14. Bay State will use the proceeds of the note to pay down short-term debt and to refinance recently matured as well as soon to mature long-term debt. These purposes are consistent with those previously approved by the Department. See, e.g., The Berkshire Gas Company, D.T.E. 98-129 (1999); New England Power Company, D.P.U. 95-101 (1995). Bay State has also demonstrated that its proposed debt issuance will occur at the lowest rate possible. As Mr. Rea explained, the rate of the Note will be tied to the applicable Treasury bond rate (based on the length of the term selected) in effect at that time or the risk free benchmark, and adjusted to reflect the premium associated with the corporation's risk profile. Tr. at 35. Mr. Rea further testified that Bay State and NiSource's credit ratings are the same with respect to Standard and Poors. Tr. at 35. With respect to Moody's credit ratings, Mr. Rea testified that Bay State's rating is one notch higher than NiSource's and that this would be reflected in the interest rate assigned to the note. Tr. at 34-38, 40-41. In accordance with SEC regulations, the note will reflect no mark-up by the lender and there is no potential financial advantage to NiSource Finance Inc. as lender. Exh. BSG-2, at 4; Tr. at 157-158.

Mr. Rea testified that the size of the proposed financing for Bay State, $50,000,000 is not sufficiently large to generate interest in the external markets and that therefore the only other option for financing would be a private placement.[2] Tr. at 147. However, the interest rate associated with a private placement would be 35 basis points higher for a ten-year note and 84 basis points higher for a twenty-year note than those projected for the proposed transaction with NiSource Finance Corp. RR-AG-1; RR-AG-2. In addition, as discussed in Section IV.C, below, the Company would avoid substantial transaction costs associated with a private placement. See, also, Tr. at 58-59. If current market conditions exist at the time Bay State is able to execute the note, a 10-year note at 6.75% would result in annual interest savings of $257,000 as compared to the costs associated with the recently matured and soon to mature long-term debt this issuance would replace. Thus, the proposed internal financing offers the most cost-effective means of reissuing Bay State's long-term debt in a manner consistent with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency.

B. Bay State Meets the Department's Net Plant Test

As discussed in Section II.C, Bay State's capital structure will continue to meet the Department's net plant test if the proposed issuance is approved. Specifically, as required by G.L. c. 164, § 16, Bay State's net utility plant (original cost of capitalizable plant, less accumulated depreciation) will equal or exceed its total capitalization (the sum of long-term debt and preferred and common stock outstanding less retained earnings). Following the proposed issuance, Bay State's net utility plant will exceed its total capitalization.

C. Exemption from the Requirements of G.L. c. 164, § 15 is in the Public Interest

Bay State has provided evidence that (1) the amount of the proposed financing is insufficient in size to attract sufficient interest in the public market, (2) a private placement would be result in a higher interest rate by approximately 35 basis points for a 10-year note or 84 basis points for a 20-year note, (3) Bay State's proposed method of financing would allow the Company to avoid substantial transaction costs; and (4) the financing proposed by the Company provides it with necessary financial flexibility. Exh. BSG-1, at 3; RR-AG-2; Tr. at 152-153. The estimated transaction costs associated with an external issuance that will be avoided are in the range of $550,000 - $825,000. Exh. BSG-2, at 4; Tr. at 79-80. These costs include, inter alia, those associated with underwriting fees and commissions, preparation of a prospectus or offering memorandum, rating agency fees, accounting fees, advertising expense, auditing fees

[2] Mr. Rea testified that private placement also would be the expected scenario for debt issuance if Bay State were an

and legal expense. Tr. at 78-80, 147-152. Thus, Bay State submits that exemption from the requirements of G.L. c. 164, § 15 is appropriate, since it is consistent with the objective of creating lower debt costs for utilities. See, MECo/EUA Merger, D.T.E. 99-47.

V. CONCLUSION

WHEREFORE, Bay State Gas Company respectfully requests that the Department (1) vote that Bay State Gas Company may issue and sell at face value to its affiliate NiSource Finance Corp. an unsecured note(s), in an amount not to exceed fifty million dollars ($50,000,000) with an interest rate not to exceed seven and three-quarters percent (7.75%) and having a term not to exceed twenty years and find that such transactions are reasonably necessary for the purposes for which such transactions have been authorized pursuant to G.L. c. 164, § 14; (2) find that the fair structural value of the Company's property, plant and equipment will exceed its outstanding stock and long-term debt and accordingly vote that the terms of the proposed financing are in accordance with the provisions of G.L. c. 164, § 16; (3) grant an exemption from the competitive bidding requirements of G.L. c. 164, § 15; and (4) grant such other relief as the Department may deem appropriate.

independent company. Tr. at 141.

Respectfully submitted,

BAY STATE GAS COMPANY

By its attorneys,

____

Maribeth Ladd
Rubin and Rudman LLP
50 Rowes Wharf
Boston, MA 02110
(617) 330-7000

____

James Keshian
Senior Attorney
300 Friberg Parkway
Westborough, MA
(508) 836-7000

Dated: December 23, 2002